Markets Summary – August 2020

Taken from the CBA Global Markets Research report, "August Month in Review", first published on 1 September 2020 and "Building Approvals – July and CoreLogic Dwelling Prices – August 2020" first published on 1 September 2020

Highlights in August

- There was no change to the RBA cash rate.
- Australian 10-year bond yields rose.
- Company earnings and new bond deals kept investors during the month.
- The Australian dollar (AUD) rose 1.1% on a Trade Weighted Index (TWI) basis.
- Australian equities rose 2.2%, the best August gain since 2009.
- Iron ore and oil prices rose while thermal coal prices fell.

Summary

Government bond yields rose towards the end of August. Australia saw a large amount of government bond issuance on the market, by both federal and state governments. In equity markets, small cap stocks outperformed the larger cap stocks and the local index enjoyed a 2.2% rise. The AUD was once again a performer against the US dollar (USD) as risk appetites returned and the global environment was more positive, rising more than 1% on a TWI basis and almost 3% on the spot as commodity prices rose sharply.

Cash

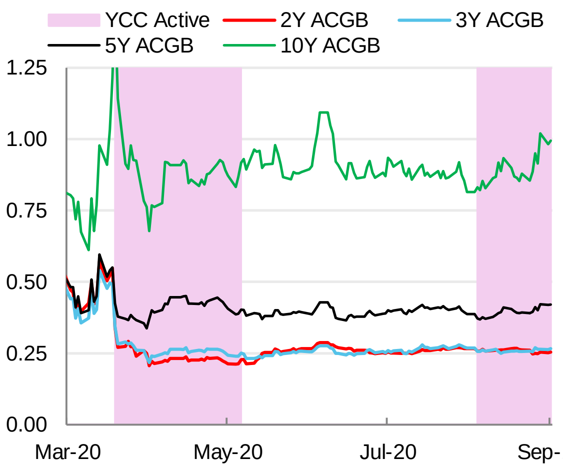
The Reserve Bank of Australia (RBA) didn't change rates in August, but continued to mull over what other policy measures could be undertaken if required. There was some movement in market rates with the bank bill swap rate (BBSW) ticking up briefly, only to reverse course and set new lows. The 3-month BBSW closed July at 0.09%, a fall of 1 basis point (bp), and equal to its lowest ever set. The 6-month BBSW set new lows at 0.145% during the month.

Australian and global fixed interest

Australian government bond yields climbed quite sharply over the month of August. The last week of the month saw a notable spike, taking the 10-year rate over 1% for the first time in several months. The US market moves seemed to drive the increase, as thoughts of inflation started to permeate the minds of investors. The US Federal Reserve did relax its inflation target to be more tolerant of an overshoot, but that will not cause inflation in and of itself. Australian markets were also under some pressure. There was a new government bond issuance of $A21bn, maturing in November 2031, and this seemed to wrong-foot the market. Despite the deal coming as a bit of a surprise, the final deal size and the book at over $A66bn were both new records.

The RBA recommenced its bond purchases in the Australian Commonwealth Government Bond market, as the April 2023 and April 2024 bond maturities were away from the yield target. The purchases pulled yields lower to meet the RBA's 3-year yield bond target of 0.25%.

Chart 1 – Australian bond yields



Source: Bloomberg, CBA

Global credit

Company earnings and new bond deals kept investors busy in August. Earnings announcements had little impact on spreads as most companies provided investors with regular updates on the impact of COVID-19 prior to their reporting date. Most companies chose to withhold their 2021 guidance given the uncertainties caused by COVID-19. Instead, companies provided better disclosures around operating metrics in July and August to give investors improved visibility around future earnings.

Aussie credit spreads continued to rally in August. However rising COVID-19 cases and the introduction of stage 4 restrictions in Victoria sent our market into further bifurcation. Spreads continued to rally in the sectors with little or no exposure to COVID risks. Telco and utility bonds performed well with spreads quickly approaching their pre-COVID levels. On the other hand spreads for airports, airlines and retail REITs are expected to take longer to normalise as the COVID-19 situation will continue to dictate social mobility and cross-border activities for some time.

Global equities

Global equities advanced in August with technology and "stay-at-home" stocks powering key US share indexes to record highs during the month. The Dow Jones index (up 7.6%) recorded its biggest August gain since 1984, while the S&P 500 index (up 7%) posted its best August performance since 1986. And the Aussie S&P/ASX200 index rose 2.2% – its best August gain since 2009. Shares were supported by a combination of investor optimism on COVID-19 treatments/vaccines, along with central bank and government stimulus measures.

Global sharemarkets began August on the front foot with investors closely monitoring efforts in Washington to negotiate a new US virus stimulus package. Sentiment was boosted by encouraging US earnings results, the recovery in global manufacturing activity and solid US jobs data. Positive developments on a COVID-19 vaccine offset US-China tensions.

In August, the US Dow Jones was up by 7.6%, the S&P 500 increased by 7% and the Nasdaq finished up 9.6%. In Asia, Japan's Nikkei gained 6.6% while Australia's ASX 200 lifted 2.2%. In Europe, the German DAX surged 5.1% and the UK FTSE lifted 1.1%.

Australian equities

Australian company earnings and dividends were hit hard by the COVID-19 health crisis and economic shock. Earnings fell by the most since the 1990s recession. According to CommSec, only 75% of companies reported statutory profits for the year to June 2020. Aggregate full-year earnings fell by 38% with dividends down 36%. Just under 69% of companies issued a dividend.

Across Australia's 22 sub-industry sectors, 16 posted gains in August. Leading the gains was Auto and Components (up by 23%), followed by Software and services (up 15.3% per cent). Telecommunications fell the most (down 10.6%). Of the size categories, the Small Ordinaries index outperformed (up 7.1%) from the MidCap50 index (up 6%), the ASX100 index (up 1.9%) and the ASX50 index (up 1.1%).

Australian dollar

The AUD rose by 1.1% on a trade-weighted basis in August, and lifted against all the major currencies.

The AUD oscillated around 0.7170 over the first half of August before appreciating strongly into the month's end. The AUD briefly fell early in August after the August Statement on Monetary Policy showed the RBA had downgraded its outlook for the economy. Rising US-China tensions also caused bouts of AUD weakness early in the month. However, the weak USD and high commodity prices kept a floor under the AUD.

The AUD appreciated towards the end of the month, the broad weakening in the USD being the major catalyst. The USD fell after Fed Chair, Jay Powell, announced that the Federal Open Market Committee (FOMC) was going to start targeting 2% Personal Consumption Expenditures price index (PCE) inflation on average, suggesting some overshoot of inflation would be accommodated.

Table 1 – Australian dollar August performance

	AUSTRALIAN DOLLAR		
	End Jul 31-Jul-20	**End Aug 31-Aug-20**	**M/M % Change**
AUD-USD	0.7143	0.7376	3.3
AUD-JPY	75.59	78.12	3.3
AUD-EUR	0.6065	0.6179	1.9
AUD-GBP	0.5459	0.5517	1.1
AUD-CHF	0.6521	0.6666	2.2
AUD-CAD	0.9578	0.9623	0.5
AUD-NZD	1.0775	1.0954	1.7
TWI	61.9	62.6	1.1
Month High		0.7403	31-Aug-20
Month Low		0.7076	3-Aug-20

Source: Bloomberg, CBA

Commodities

Commodity prices finished mostly higher in August as the US dollar weakened, and on strong Chinese demand. China is the most critical consumer of mining commodities, accounting for 40-60% of metal and iron ore demand. Improving industrial output outside of China has also helped prices. Liquefied natural gas (LNG), nickel and iron ore saw the strongest gains, while thermal coal fell.

Spot LNG prices lifted strongly in August on easing oversupply concerns. While LNG demand has picked up as COVID-19 lockdowns ease, particularly in China, India and Japan, the prospect of strong LNG demand during the winter months in north Asia is likely at the heart of the recent rally. While part of the demand hope is linked to a cold winter, it is the coal-to-gas switching potential in Japan and South Korea that could drive LNG demand higher from October to December. Supply cuts in the US help explain the boost in spot LNG prices too.

Iron ore was also another standout performer last month. The steel-making ingredient rose as steel mill margins in China stayed healthy. Nickel prices also rose strongly in August. A weaker US dollar and strong Chinese demand were notable drivers, but supply concerns was what set nickel apart from other base metals. Thermal coal prices from Australia declined in August, consistent with subdued power demand. Japan, which accounts for most of Australia's thermal coal exports, is on course for its power demand to fall 2% per year in August.

Australian property prices

Across the eight capital cities, combined dwelling prices fell 0.5% in August and the annual growth rate eased to 6.3%. Prices are down 2.5% since their most recent peak in April 2020. However the rate at which dwelling prices are falling slowed to 0.5% in August from 0.8% in July and June.

In the context of an extraordinary negative economic shock, the fall in national dwelling prices has so far been modest – an outcome that has surprised us. In addition, the disparity in outcomes between capital cities is also larger than anticipated.

Looking at the details by capital city, Melbourne recorded the largest fall, down 1.2% in August. Melbourne dwelling prices have fallen 4.6% since March 2020 which is significantly more than the 2.5% fall across all eight capital cities. The escalation of restrictions in tandem with rising COVID-19 cases over July and August is clearly weighing on households in Victoria.

In Sydney and Brisbane dwelling prices also retreated, falling 0.5% and 0.1% respectively over August. Falls here also moderated when compared to June and July. In Adelaide and Perth prices were flat in August and are broadly tracking sideways. In the smaller cities of Darwin, Canberra and Hobart prices lifted over August.

Chart 2 – Dwelling Price moves – monthly change and annual change

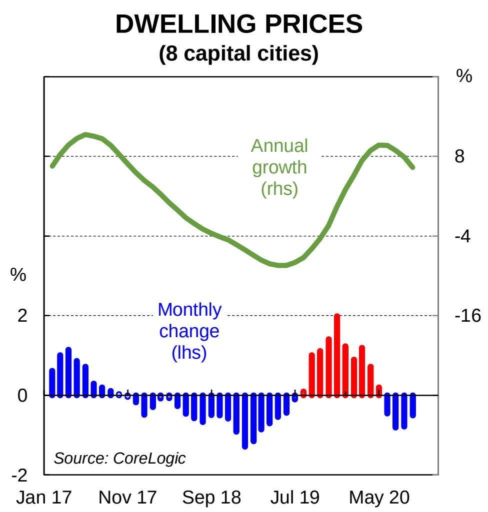


Chart 3 – Dwelling Price Index